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IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

MANUFACTURERS HANOVER LEASING CORPORATION,
Petitioner,

v.

HAROLD G. LOWERY,
Trustee of Robinson Brothers Drilling, Inc.
and Robinson Brothers Drilling Company,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* AND BRIEF OF THE COMMERCIAL FINANCE ASSOCIATION, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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February 1994

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MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE*

Pursuant to Rule 37.2 of the Rules of this Court, the Commercial Finance Association, Inc. ("CFA") respectfully moves for leave to file the attached brief as *amicus curiae* in support of the petition for a writ of certiorari submitted by Manufacturers Hanover Leasing Corporation. The respondent, Harold G. Lowery, has refused to consent to the filing of this brief.

The CFA is a non-profit membership corporation organized under the laws of Delaware, with its principal office in New York. It is the national trade association for financial institutions that provide asset-based commer-

cial financing. With over 200 members, the CFA includes nearly all of the major money center banks and important regional banks, small family-owned finance companies, and larger commercial lenders that are publicly held or owned by industrial companies and foreign banks.

Members of the CFA operate on a national, regional and local scale, providing operating funds and other types of financing to businesses. Most of these businesses are small or medium-sized companies dependent upon the availability of secured financing for the opportunity to grow. The secured financing provided by CFA members comprises a substantial portion of the national credit market.

The issue presented in this case has "generated nationwide concern within the lending community." [1] The issue is whether a lender faces substantially increased liability for preferences under the Bankruptcy Code simply because its loan has been guaranteed by an "insider" of the debtor. The lower courts are sharply split on this important question that arises frequently in bankruptcy proceedings.

Guaranties are common components of financial transactions, and the guarantor is usually an "insider" of the borrower, as that term is used in the Bankruptcy Code. Many loans, particularly to small or newly-formed businesses and to companies in poor financial condition, would not be made without the additional support provided by a guaranty. Lenders also desire guaranties so that in times of financial difficulty the borrower's managers have a continuing stake in the viability of the business; and in the event of bankruptcy, they have an incentive to assist in collecting debts and liquidating collateral. Also, when several affiliated corporations are under common ownership, lenders typically request intercorporate guaranties to

[1] W.A. Effross, *Deprizio's Honor: Lenders, Insider Guarantors and the Prisoners' Dilemma*, 21 Seton Hall L. Rev. 774, 775 (1991).

avoid problems resulting from transactions between the affiliates.

The members of the CFA, as well as all providers of commercial and consumer credit, are vitally concerned about an interpretation of the federal bankruptcy law, adopted by some courts but not others, which transforms a guaranty from a source of security into a source of risk. The CFA believes that the line of cases followed by the court below should be overruled. Regardless of how this issue is ultimately resolved, creditors and debtors need a clear answer to an important question that arises constantly in the administration of the bankruptcy laws, and a definitive answer is available only from this Court.

Accordingly, the CFA urges the Court to grant leave to file the *amicus curiae* brief that accompanies this motion.

Respectfully submitted,

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QUESTION PRESENTED

Section 547(b) of the Bankruptcy Code provides that a transfer by a debtor on an antecedent debt to a creditor within 90 days of bankruptcy can be avoided. With respect to a creditor who is an insider of the debtor, however, transfers within one year of bankruptcy can be avoided. The question presented is:

> Whether a transfer by a debtor on an antecedent debt between 90 days and one year preceding the date of bankruptcy to a non-insider creditor, which is not otherwise avoidable, can be avoided where such creditor holds a guaranty of the antecedent debt from an insider of the debtor, pursuant to 11 U.S.C. §§ 547(b) and 550(a) of the Bankruptcy Code?

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BRIEF OF THE COMMERCIAL FINANCE ASSOCIATION, INC. AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF *AMICUS CURIAE*

The interest of *amicus curiae* is set forth in the accompanying motion for leave to file this brief.

REASONS FOR GRANTING THE PETITION

This case gives the Court its first opportunity to resolve the "storm of controversy" [1] that has followed in the wake

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[1] D.W. Baker, *Repayments of Loans Guaranteed by Insiders as Avoidable Preferences in Bankruptcy: Deprizio and Its Aftermath*, 23 U.C.C.L.Jnl. 115 (1990).

of the decision that is popularly known as *"Deprizio"*—*Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186 (7th Cir. 1989). That decision has provoked not only a sharp division among the lower courts, but also a flood of litigation, a wealth of legal commentary, and a massive effort by lenders to restructure transactions so as to minimize the preference risks if a bankruptcy case happens to be filed in a district that follows *Deprizio*.

By granting the petition, the Court will resolve an important and constantly recurring issue of bankruptcy law that has divided the lower courts and that has disrupted commercial lending practices. The issue is whether a lender faces increased liability for preferences under the Bankruptcy Code simply because its loan has been guaranteed by an "insider" of the debtor. Section 547(b) of the Bankruptcy Code, which defines the elements of a preference, draws a careful distinction between ordinary creditors and insiders: an ordinary creditor is subject to preference liability *only* for payments received during the 90-day period preceding bankruptcy, but for insiders the preference period reaches back an entire year before bankruptcy.[2] Some courts have construed Section 550 of the Code to impose preference liability on *non*-insiders for payments received during the extended one-year preference period if the debt was guaranteed by an insider. This reading of the Bankruptcy Code "produces the anomalous result that a creditor who does not demand a guarantee can be in a better position than one who does." 4 L. King, *Collier on Bankruptcy* ¶ 550.02, at 550-14 (15th ed. 1993).

Granting the petition will also give this Court an opportunity to provide guidance concerning two principles

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[2] The fourth element of a preference, as set forth in Section 547(b)(4) of the Bankruptcy Code, 11 U.S.C. § 547(b)(4), is that the transfer must have been "made (A) on or within 90 days before the filing of the petition; or (B) between ninety days and one year before the filing of the petition, if such creditor at the time of such transfer was an insider. . . ."

of statutory construction that have confounded the lower courts. The first involves determining the "plain meaning" of statutes when separate provisions point in different directions and "there is no helpful legislative history." [3] Section 547(b)(4) of the Bankruptcy Code distinguishes between insiders and ordinary creditors, but, under the *Deprizio* court's interpretation, Section 550 negates that distinction.[4] The second principle of statutory construction concerns the significance of the well-established body of case law under the Bankruptcy Act of 1898 (the prior version of the bankruptcy statute). "The *Deprizio* rule represents a radical departure from pre-Bankruptcy Code practice," yet there is "no mention in the legislative record that Congress even considered abandoning the longstanding rule." *In re Erin Food Services, Inc.*, 980 F.2d 792, 797 & n.9 (1st Cir. 1992). The significance of pre-Code authority is a topic on which several Justices have perceived inconsistencies in this Court's decisions.[5]

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[3] *Deprizio*, 874 F.2d at 1196.

[4] "Section 547(b)(4) distinguishes according to [whether Guarantor is an 'insider'], but § 550 does not. It says that if a transfer is recoverable by the trustee, it may be recovered from *either* the 'initial transferee' (Lender) or the 'entity for whose benefit such transfer was made' (Guarantor)."

Deprizio, 874 F.2d at 1190 (Seventh Circuit's brackets and emphasis, *quoting Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 894 (7th Cir. 1988)).

[5] In *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 501 (1986), the Court stated:

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. . . . The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.

The proper application of this canon of construction to the Bankruptcy Code has produced considerable disagreement. *Compare Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 563 (1990), *with id.* at 570 (Blackmun, J., joined by O'Connor, J., dissenting); *compare United States v. Ron Pair Enterprises, Inc.*,

I. A DECISION BY THIS COURT IS ESSENTIAL TO RESOLVE THE SHARP SPLIT AMONG THE LOWER COURTS.

The Seventh Circuit's decision in *Deprizio* has been followed by the Sixth, Ninth and Tenth Circuits,[6] yet "the majority of lower courts have held to the contrary." 4 L. King, *Collier on Bankruptcy* ¶ 550.02, at 550-13 (15th ed. 1993). The *Deprizio* rule has been rejected by courts within the Second, Third, Fourth, Fifth, Eighth and Eleventh Circuits,[7] and thus is not followed in such major financial centers as New York City, Philadelphia, Miami, Pittsburgh, Dallas and Baltimore. Although no court of appeals has expressly rejected the *Deprizio* holding, it is based on an interpretation of the Bankruptcy Code that is contrary to the Fifth Circuit's reasoning in applying

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489 U.S. 235, 245 (1989), *with id.* at 249 (O'Connor, J., joined by Brennan, Marshall and Stevens, JJ., dissenting); *compare Dewsnup v. Timm*, 112 S. Ct. 773 (1992), *with id.*, 112 S. Ct. at 786 (Scalia, J., joined by Souter, J., dissenting).

[6] *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1990); *In re Suffola, Inc.*, 2 F.3d 977 (9th Cir. 1993); *In re Robinson Bros. Drilling, Inc.*, 892 F.2d 850 (10th Cir. 1989) (*per curiam*).

[7] *In re Rubin Bros. Footwear, Inc.*, 119 B.R. 416 (S.D.N.Y. 1990); *In re J.T.L. Supermarket Corp.*, 145 B.R. 3 (Bankr. N.D.N.Y. 1992); *In re Performance Communications, Inc.*, 126 B.R. 473 (Bankr. W.D. Pa. 1991); *In re R.A. Beck Builder, Inc.*, 34 B.R. 888, 894 (Bankr. W.D. Pa. 1983); *In re Mercon Industries, Inc.*, 37 B.R. 549 (Bankr. E.D. Pa. 1984); *In re Arundel Housing Components, Inc.*, 126 B.R. 216 (Bankr. D. Md. 1991); *In re Aerco Metals, Inc.*, 60 B.R. 77 (Bankr. N.D. Tex. 1985); *In re Midwestern Cos.*, 102 B.R. 169 (W.D. Mo. 1989); *In re Grove Peacock Plaza, Ltd.*, 142 B.R. 506 (Bankr. S.D. Fla. 1992); *In re Cove Patio Corp.*, 19 B.R. 843 (Bankr. S.D. Fla. 1982). *But see In re Pine Springs Farm & Casino, Inc.*, 139 B.R. 90 (Bankr. N.D.N.Y. 1992); *In re Dovetailed Enterprises, Inc.*, 136 B.R. 652 (Bankr. W.D. Va. 1991); *In re David Jones Builder, Inc.*, 129 B.R. 682, 693 (Bankr. S.D. Fla. 1991); *In re Installation Services, Inc.*, 101 B.R. 282 (Bankr. N.D. Ala. 1989).

Sections 547 and 550,[8] and contrary to all the relevant decisions construing the Bankruptcy Act of 1898.[9] The First and Fourth Circuits have specifically refused to rule on the validity of the "very controversial" *Deprizio* theory.[10]

This conflict concerning a fundamental provision of bankruptcy law is sure to persist, given the strongly held view by many judges that the *Deprizio* decision is profoundly wrong. *See, e.g., In re Performance Communications, Inc.*, 126 B.R. 473, 476-77 (Bankr. W.D. Pa. 1991) ("*Deprizio* is fatally flawed," "methodologically unsound," and "grossly inequitable"); *In re Rubin Bros. Footwear, Inc.*, 119 B.R. 416, 425 (S.D.N.Y. 1990) (court will not follow the "much criticized" *Deprizio* decision unless required by the Second Circuit); *In re Arundel Housing Components, Inc.*, 126 B.R. 216, 219 (Bankr. D. Md. 1991) ("This Court strongly disapproves of the *Deprizio* decision because it represents an incorrect interpretation of the law whose application would subvert justice, produce much needless mischief and create an unfortunate result in the instant case"). Thus, the Court's ordinary preference for a circuit conflict to justify certiorari ought not to be slavishly adhered to in this case,

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[8] In *In re Compton Corp.*, 831 F.2d 586 (5th Cir. 1987), *on reh'g*, 835 F.2d 584 (1988), the Fifth Circuit adopted the "Direct/Indirect Transfer Doctrine." The court held that a single conveyance of property could constitute "two transfers, one direct and one indirect. The direct transfer . . . may be valid and not subject to a preference attack," whereas the indirect beneficiary may be liable. 831 F.2d at 591. The *Deprizio* court had to reject this doctrine in order to reach its decision. 874 F.2d at 1195-96. The Fifth Circuit recently acknowledged the tension between its *Compton* decision and *Deprizio*. *See In re T.B. Westex Foods, Inc.*, 950 F.2d 1187, 1193-94 (5th Cir. 1992).

[9] *See, e.g., Dean v. Davis*, 242 U.S. 438, 443 (1917); *Aulick v. Largent*, 295 F.2d 41, 52 (4th Cir. 1961).

[10] *In re Jefferson Bigelow Design Group, Inc.*, 956 F.2d 479, 483 n.2 (4th Cir. 1992); *In re Erin Food Services, Inc.*, 980 F.2d 792, 798-99 (1st Cir. 1992).

where the division among the lower courts plainly exists and causes a serious disruption in the primary commercial activity of banks and other lending institutions.

The lower court decisions are sharply divided about the plain meaning of the Bankruptcy Code provisions at issue here, and whether those provisions are ambiguous. The Ninth Circuit recently followed *Deprizio* based on its view that "Section 550 is unambiguous." *In re Suffola, Inc.*, 2 F.3d 977, 983 (9th Cir. 1993). Yet, the First Circuit saw an "inherent ambiguity in Bankruptcy Code § 550." *In re Erin Food Services, Inc.*, 980 F.2d 792, 797 n.9 (1st Cir. 1992). Still other courts have concluded that the *Deprizio* interpretation is *contrary* to "the 'clear,' 'unambiguous' and 'unconditional' language of the statute." *In re Midwestern Cos.*, 102 B.R. 169, 172 (W.D. Mo. 1989).[11]

The courts are also divided as to whether the *Deprizio* rule serves the policies of the Bankruptcy Code. The Seventh Circuit thought that the rule reasonably balanced the interests of all creditors. *Deprizio*, 874 F.2d at 1195, 1198. Other courts, however, believe the *Deprizio* rule "would likely impede the availability of credit to ailing businesses," thereby precipitating bankruptcies. *In re Rubin Bros. Footwear, Inc.*, 119 B.R. 416, 425 (S.D.N.Y. 1990). If lenders must face added preference risks by obtaining guaranties from insiders, they "will be less likely to make such loans to small businesses, new businesses, and businesses of the entrepreneurial type." *In re J.T.L. Supermarket Corp.*, 145 B.R. 3, 4 (Bankr. N.D.N.Y. 1992). The point was stated more bluntly by

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[11] *Accord, In re Grove Peacock Plaza, Ltd.*, 142 B.R. 506, 516 (Bankr. S.D. Fla. 1992) (rejecting *Deprizio* based on "clear, unambiguous language"); *In re Performance Communications, Inc.*, 126 B.R. 473, 477 (Bankr. W.D. Pa. 1991) (*Deprizio* "ignores the plain, unambiguous language" of Code provisions).

Professor Baker: *Deprizio* "will severely impair the ability of small, closely held businesses to obtain credit" [12]

In sum, the conflict over *Deprizio* is deep and wide, and can only be resolved by a decision of this Court. No good reason exists to postpone the inevitable—review by this Court—and allow the conflicting interpretations of the Bankruptcy Code to distort lending practices, or worse, to serve as a trap for lending institutions that do not accurately predict whether *Deprizio* will apply to their transactions.

II. THE UNCERTAINTY CREATED BY *DEPRIZIO* HAS DISRUPTED LENDING PRACTICES AND THE ADMINISTRATION OF BANKRUPTCY CASES.

The specter of "*Deprizio* liability" has had a serious impact on credit transactions. In the past, lenders were always better off—or at least no worse off—if they obtained a guaranty. Now, lenders face a difficult decision that must be evaluated on a case-by-case basis. The support of a guaranty may be critical to the soundness of a credit transaction, but if a court later decides to apply the *Deprizio* rule, the lender will face four times as much preference exposure (one year of payments versus 90 days) than if it did not hold a guaranty. Under *Deprizio*, the lender is "penalized for its prudence in seeking a guarantor." *In re R.A. Beck Builder, Inc.*, 34 B.R. 888, 894 (Bankr. W.D. Pa. 1983).

Lenders must also consider the pros and cons of various techniques for structuring transactions so as to avoid the formalistic *Deprizio* rule. On this subject there has been an outpouring of legal analysis. For example, one school of thought is that a guaranty from an insider will not result in *Deprizio* liability if the guarantor waives his right to subrogation and reimbursement from the bor-

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[12] Baker, *supra* note 1, at 148.

rower.[13] However, such waivers are often difficult to negotiate, and it has been argued that the lender may be even worse off in bankruptcy if the transaction is structured in this manner.[14] Another recommendation is that lenders seek a guaranty limited to a sum which is much less than the total amount of the loan.[15] Unfortunately, no one can be certain how such transactions would be treated by courts construing the Bankruptcy Code. "*Deprizio* thrusts those who extend credit, and their counsel, into largely unchartered waters." D.I. Katzen, *Deprizio and Bankruptcy Code Section 550: Extended Preference Exposure Via Insider Guarantees, and Other Perils of Initial Transferee Liability*, 45 Bus. Law. 511 (1990).

In the final analysis, the decision to extend credit depends primarily on two considerations: the risk of nonpayment and the price received. Uncertainty about the *Deprizio* rule adds to the risk, and therefore the cost, of credit.

Uncertainty over the *Deprizio* rule also has a major impact on the administration of bankruptcy cases. Currently, about 70,000 businesses file for bankruptcy each

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[13] The theory is that if the guarantor has no claim against the debtor, then the guarantor is not a "creditor," as required by Section 547(b)(1) (transfer must be "to or for the benefit of a creditor").

[14] *See* P.L. Borowitz, *Waiving Subrogation Rights and Conjuring Up Demons in Response to Deprizio*, 45 Bus. Law. 2151, 2168 (1990) ("institutional lenders should think more than twice before they revise their guaranty forms to require guarantors to waive subrogation rights"). This author believes that a loan payment might in some circumstances be characterized as a fraudulent conveyance for the benefit of the insider-guarantor if the insider would otherwise have been required to repay the loan without recourse to the debtor.

[15] The theory is that a partial repayment of the loan will not "benefit" the guarantor if the remaining loan balance still exceeds the maximum amount of the guaranty; the guarantor's potential liability remains the same after the payment of the loan.

year,[16] and preference litigation is a major component of many of those cases, consuming a substantial amount of judicial time and resources. "Preference litigation plays an integral role in many bankruptcy cases, whether liquidation or reorganization." M. Cook, *Bankruptcy Litigation Manual* 409 (1991).

In every court without a controlling precedent, there is uncertainty, and hence the likely prospect of expensive litigation, about whether the *Deprizio* rule should be adopted in preference cases. Even where *Deprizio* clearly applies, courts must address various ancillary questions. For example, they must decide what constitutes a "benefit" to an insider. Does the insider benefit if the payment of a debt helps stave off bankruptcy? *See In re Erin Food Services, Inc.*, 980 F.2d 792 (1st Cir. 1992) (insider does not benefit; reversing lower courts). Does the insider benefit if he is hopelessly insolvent whether or not the debt is paid? *See Lowrey v. Manufacturers Hanover Leasing Corp.*, 6 F.3d 701 (10th Cir. 1993) (insider benefits). Is the "benefit" determined as of the date of payment or as of the date of bankruptcy? *Compare Lowrey* (date of payment) *with In re Suffola, Inc.*, 2 F.3d 977 (9th Cir. 1993) (date of bankruptcy). Does a creditor face preference liability if its loan was fully secured by collateral at the time of payment? In dictum, *Deprizio* said the creditor would not be liable, but fully-secured creditors were held liable in both *Suffola* and *In re C-L Cartage Co.*, 899 F.2d 1490 (6th Cir. 1990).

The *Deprizio* line of cases thus imposes two significant practical burdens upon lenders. First, it interferes with their basic credit decisions by interjecting a potentially unpredictable legal variable into their calculations. Second, it imposes upon lenders (and federal courts) a significant litigation burden, both in resolving the applica-

[16] *See Washington Post*, March 18, 1993, at C15 (citing report by the American Bankruptcy Institute based on statistics of the Administrative Office of U.S. Courts).

bility of *Deprizio* and in having to decide the myriad issues that arise if *Deprizio* is held to apply. Because the financial world without *Deprizio* poses fewer risks to creditors and is much simpler for lenders and the courts, the time has come to decide whether Congress really intended *Deprizio* to be the law. Only this Court can resolve that issue once and for all.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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